

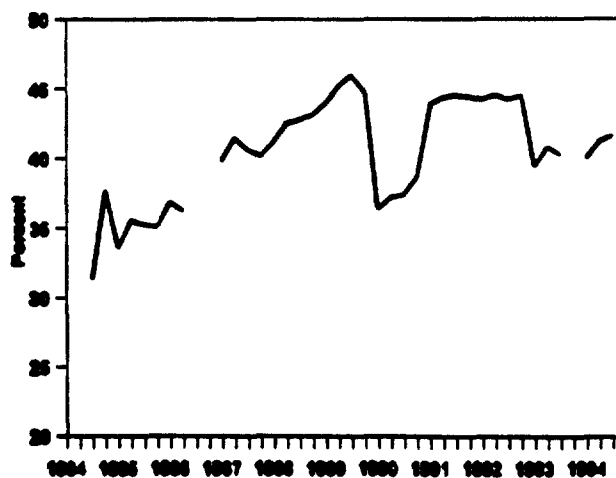
have existed in the interstate long-distance market. A decline in the rate of net entry may be coincident with the period of increased AT&T pricing flexibility and advertising expenditure, suggesting that advertising may have erected a barrier to entry for resellers. Thus, although entry may have caused increased competitive pressures on incumbent IXCs, the pressures may have been ameliorated by increased advertising rather than lower prices.

G. Financial Performance

In a competitive market, prices will fall, output will increase and profits will tend towards zero. Despite new entry since divestiture, AT&T still retains some form of market power in the interstate long-distance market. Although prices have fallen and output has increased, some measures of AT&T's rate of profits have not fallen; rather, they have increased.

Figure 8 shows AT&T's gross margin,⁴⁵ defined as net sales

Figure 8
AT&T Gross Margin, 1984-1994



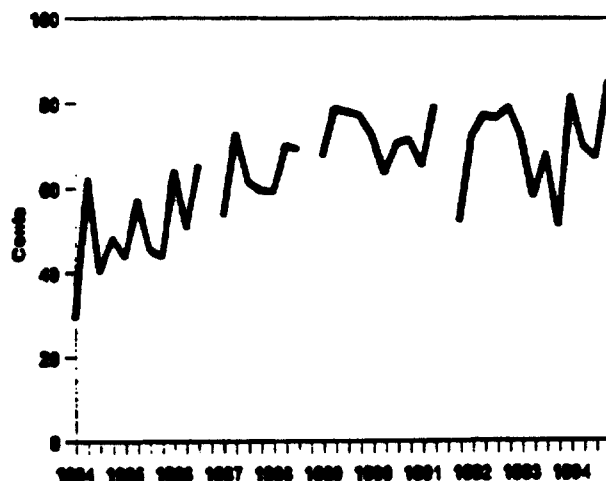
Source: Compustat data from Pacific online database.

⁴⁵ Economists generally avoid using accounting data to infer market power. We therefore are relying on the (continued...)

less cost of goods sold over net sales. (The gaps in this chart are due to write downs or special circumstances.) Since divestiture, AT&T's margin has actually increased, from 31.4 percent in the third quarter of 1984 to 41.6 percent in the third quarter of 1994. The lower prices offered by AT&T are more than offset by cost decreases, particularly carrier access rates.

Figure 9 shows another measure of profit—earnings per share. (The gaps in this chart are quarters during which AT&T took charges for business restructuring or depreciation of analog plant and equipment.) Since divestiture, AT&T's real earnings per share have almost tripled, from 30 to 85 cents a share.

Figure 9
AT&T Real Earnings per Share 1984-1994
(1994 dollars)



Source: Computed data from Purdett online database.

⁶⁵ (...continued)
trend in these rates over time, assuming that whatever the relationship between the accounting and economic rates of profit remains constant.

We have measured the correlation between the profit rates and reductions in access charges.⁶⁶ Over the period from the third quarter 1984 through the third quarter of 1994, each 10 percent reduction in carrier access price has been associated, on average, with a 1.6 percentage point increase in AT&T's gross margin (as computed by AT&T on their financial statements filed with the Securities and Exchange Commission). Over the period from the third quarter 1984 through the fourth quarter 1994, each 10 percent reduction in carrier access price has been associated, on average, with a 3.8 cent increase in quarterly earnings per share (as computed from AT&T financial statements). The results of the analysis are not significantly different if the AT&T price cap period is considered separately. Given the latter results, we estimate that the carrier access price reductions that took place between 1984 and 1994 are associated with 1994 earnings for AT&T about \$1.56 billion higher than what they would have been in the absence of access charge reductions between 1984 and 1994.

We do not observe evidence of pressures to move price toward costs. Margin, which provides a measure of the gap between price and cost (in all of AT&T's lines of business) has increased over the period of study. Real earnings per share has also increased over the same period. These results do not suggest that competitive pressure from within the interstate long-distance market has substantially constrained the behavior of AT&T, even during the price cap period.

⁶⁶ We have performed a regression analysis using a constant and the log of the access price index we documented in a previous section as right-hand variables and the level of earnings or gross margin as the left-hand variable.

IV. CONCLUSIONS

The preponderance of evidence presented here—prices not moving toward access costs, limited price competition, increased advertising, evidence of continuing entry, increased margins and earnings—demonstrates that it is very unlikely that the interstate long-distance market is effectively competitive. The other evidence—pricing at the cap, market shares settling near sixty percent—suggests that regulation and the threat of antitrust intervention is the constraining force in the market.

While effective competition in long-distance markets could have produced very large consumer benefits, the consumer welfare gains that have been realized (perhaps only because the FCC required AT&T to reflect changes in access charges in price) are a fraction of the gains that could have been realized. In some long-distance markets, particularly the markets in which large business customers purchase long-distance services, these radical changes in the basic statistics of the market have lead to substantial benefits for consumers. Customers in other markets, particularly the markets in which residential customers purchase long-distance telephone services, have not yet received the substantial benefits that efficient competition in long-distance markets promises. In addition, producer welfare (economic profits) seems to have increased in a period of allegedly increased competition as the benefits of access charge reductions have flowed to interexchange company stockholders rather than customers. Thus because competition has not reduced prices, AT&T has been able to keep margins earned on all new minutes stimulated by the price reductions caused by access charge reductions. The substantial price reductions and outward shifting of the interstate toll demand curve that would be expected to arise from vigorous toll competition have yet to materialize.

Changes in Carrier Access Charges
and
Changes in AT&T Interstate Toll Rates
(\$ Millions)

	Access Charge Changes	Other Exogenous Cost Changes	Access & Cost Changes	Cum. Cost Change	AT&T Rate Changes	Difference	Cumulative Rate Changes
10/1/84	(\$1,400)	\$0	(\$1,400)	(\$1,400)	(\$1,400)	\$0	(\$1,400)
01/1/85	\$274	\$0	\$274	(\$1,126)	\$0	(\$274)	(\$1,400)
04/1/85	\$0	\$0	\$0	(\$1,126)	\$303	\$303	(\$1,097)
07/1/85	(\$1,157)	\$0	(\$1,157)	(\$2,283)	(\$1,157)	\$0	(\$2,254)
10/1/85	(\$525)	\$0	(\$525)	(\$2,808)	\$0	\$525	(\$2,254)
01/1/86	\$0	\$0	\$0	(\$2,808)	(\$135)	(\$135)	(\$2,389)
01/1/86	\$25	\$0	\$25	(\$2,783)	\$248	\$223	(\$2,141)
02/1/86	\$0	\$0	\$0	(\$2,783)	\$17	\$17	(\$2,124)
04/1/86	\$0	\$0	\$0	(\$2,783)	\$72	\$72	(\$2,052)
06/1/86	(\$2,000)	\$0	(\$2,000)	(\$4,783)	(\$2,000)	\$0	(\$4,052)
01/1/87	(\$1,865)	\$0	(\$1,865)	(\$6,648)	(\$1,865)	\$0	(\$5,917)
03/1/87	\$0	\$0	\$0	(\$6,648)	\$18	\$18	(\$5,899)
07/1/87	(\$593)	\$0	(\$593)	(\$7,241)	(\$593)	\$0	(\$6,492)
12/1/87	\$0	\$0	\$0	(\$7,241)	\$77	\$77	(\$6,415)
01/1/88	(\$772)	(\$524)	(\$1,296)	(\$8,537)	(\$772)	\$524	(\$7,187)
06/1/88	\$0	\$0	\$0	(\$8,537)	\$28	\$28	(\$7,159)
06/1/88	\$0	\$0	\$0	(\$8,537)	\$174	\$174	(\$6,985)
07/1/88	(\$776)	\$0	(\$776)	(\$9,313)	(\$785)	(\$10)	(\$7,770)
01/1/89	(\$365)	(\$141)	(\$506)	(\$9,819)	(\$505)	(\$58)	(\$8,365)
07/1/89	(\$482)	(\$1)	(\$483)	(\$10,322)	(\$253)	\$229	(\$8,618)
01/1/91	(\$130)	\$0	(\$129)	(\$10,451)	\$22	\$151	(\$8,597)
02/1/91	\$47	\$0	\$47	(\$10,404)	\$63	\$16	(\$8,534)
02/21/91	\$11	\$0	\$11	(\$10,393)	(\$10)	(\$21)	(\$8,544)
07/1/91	(\$251)	(\$9)	(\$260)	(\$10,652)	\$9	\$258	(\$8,535)
01/1/92	\$97	(\$25)	\$73	(\$10,580)	\$138	\$66	(\$8,397)
07/1/92	(\$165)	\$107	(\$58)	(\$10,638)	(\$41)	\$17	(\$8,439)
01/1/93	\$80	\$0	\$80	(\$10,558)	(\$78)	(\$138)	(\$8,517)
02/03/93	(\$58)	\$0	(\$58)	(\$10,616)	\$0	\$58	(\$8,517)
07/1/93	\$15	\$281	\$296	(\$10,340)	\$40	(\$256)	(\$8,477)
01/1/94	(\$34)	\$11	(\$22)	(\$10,362)	\$329	\$352	(\$8,147)
07/1/94	(\$223)	(\$99)	(\$322)	(\$10,684)	(\$327)	(\$36)	(\$8,474)
08/01/94	\$0	\$228	\$228	(\$10,456)	\$20	(\$209)	(\$8,455)
09/1/94	\$0	\$86	\$86	(\$10,370)	\$0	\$86	(\$8,455)
11/1/94	\$0	(\$27)	(\$27)	(\$10,397)	(\$19)	\$8	(\$8,474)
01/1/95	(\$13)	\$0	(\$13)	(\$10,410)	\$0	\$13	(\$8,474)
07/1/95	\$0	\$8	\$8	(\$10,402)	\$198	\$188	(\$8,278)
08/1/95	\$0	\$0	\$0	(\$10,402)	\$19	\$19	(\$8,259)
02/27/95	\$0	\$0	\$0	(\$10,402)	(\$583)	(\$583)	(\$8,842)
04/1/95	\$0	\$0	\$0	(\$10,402)	\$321	\$321	(\$8,521)
TOTALS	(\$10,299)	(\$103)	(\$10,402)	(\$10,402)	(\$8,521)	\$1,881	(\$8,521)
1/81-4/85	(\$644)	\$863	(\$80)	(\$80)	\$96	\$178	\$96

Changes in Exogenous Costs

	Market Cost Changes				AT&T-Specific Cost Changes				
	Tax	COCOT	ADA-TRS	OBRA (fees)	Depreciation	COMSAT	FAS 106	FAS 112	Asset Write Down
18-Dec-89					(\$141.4)				
28-Jun-90	(\$1.4)				\$0.6				
18-Dec-90	\$0.5								
17-May-91	\$30.8								
28-Jun-91						(\$39.7)			
19-Dec-91					(\$24.8)				
15-May-92	\$72.9	\$10.4			(\$0.4)	\$26.9			
30-Jun-92	(\$2.7)								
17-May-93	\$38.1								
30-Jun-93							\$242.9		
17-Dec-94			\$11.5						
17-May-94	\$9.7	\$3.6	(\$1.5)	\$3.2	\$0.6		(\$01.0)	\$231.1	
30-Jun-94				(\$3.2)	(\$1.2)			(\$231.1)	
01-Aug-94								\$208.7	
11-Aug-94				.					(\$12.0)
18-Nov-94								(\$27.0)	
19-Dec-94				\$7.8					
Total	\$147.9	\$14.0	\$10.0	\$7.8	(\$166.6)	(\$12.8)	\$161.9	\$269.7	(\$12.0)
1/91 - 12/94	\$148.8	\$14.0	\$10.0	\$7.8	(\$25.8)	(\$12.8)	\$161.9	\$269.7	(\$12.0)
Market 88-94		\$171.9		Market 91-94	\$180.6				
AT&T-specific		\$240.2		AT&T-specific	\$301.0				
Total		\$412.1		Total	\$561.6				